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IRS Reports More Disclosures Under OVDP, Streamlined Filing Compliance Program

IR-2015-116

Disclosures under the IRS's Offshore Voluntary Compliance Program (OVDP) and the related Streamlined Filing Compliance Program continue to increase, the IRS has announced. The OVDP has generated some $8 billion, the agency added. The IRS also highlighted the U.S. Department of Justice (DOJ)'s Swiss Bank Program.

- ***Take Away.*** "The announcement by the IRS makes clear the risk to non-compliant taxpayer because of global developments regarding the automatic exchange of tax exchange now in effect," Matthew Lee, partner, Blank Rome, LLP, Philadelphia, told Wolters Kluwer. "Both the *Foreign Account Tax Compliance Act* (FATCA), which is now fully effective, and the OECD's Common Reporting Standard, which starts to become effective in 2016, are mechanisms to provide tax authorities throughout the world (including the U.S.) with information about taxpayers with offshore assets," Lee added.

Background

U.S. taxpayers, including U.S. citizens living abroad and aliens who reside in the U.S., are required to report and pay taxes on their worldwide income, including income from their foreign assets. U.S. taxpayers must report foreign accounts to the IRS on Form 1040, Schedule B (Part III); Assets of certain values to the IRS on Form 8938, Statement of Foreign Financial Accounts; and foreign accounts above $10,000 to Treasury's Financial Crimes Enforcement Network (FinCEN), using Form 114, Report of Foreign Bank and Financial Accounts (FBAR).

- ***Comment.*** Beginning with tax year 2011, the penalty for failing to file Form 8938 is $10,000, with an additional $10,000 added for each month the failure continues beginning 90 days after the taxpayer is notified of the delinquency, up to a maximum of $50,000 per return. The civil penalty for willfully failing to file an FBAR may be as high as the greater of $100,000 or 50 percent of the total balance of the foreign financial account per violation. Non-willful violations that the IRS determines were not due to reasonable cause are subject to a $10,000 penalty per violation.

OVDP. The IRS has provided several OVDP programs in recent years. The current program launched in 2012. The program imposes a penalty, in addition to back taxes and interest, for disclosures.

Streamlined process. The IRS subsequently announced the streamlined process for taxpayers who failed to disclose foreign accounts but who the agency determined were not willful evaders. The streamlined procedures were only available to nonresidents who failed to file any tax returns and who owed $1,500 or less in taxes per year. Later, the IRS eliminated

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IRS's Implementation Of FATCA Improving, But More Work Is Needed

TIGTA Ref. No. 2015-30-085

The Treasury Inspector General for Tax Administration (TIGTA) has issued a new report on the IRS's implementation of the *Foreign Account Tax Compliance Act* (FATCA). TIGTA discovered that the IRS must update its FATCA Compliance Roadmap and should consider instituting a quality review process for its transcription activities for the paper Forms 8938, Statement of Specified Foreign Financial Assets.

- ***Take Away.*** In general, TIGTA reported favorably on the IRS's implementation of FATCA to date. It found that the IRS has made a reasonable effort at providing educational outreach to external stakeholders affected by FATCA.

Compliance roadmap

TIGTA found that the IRS needs to update its FATCA Compliance Roadmap to provide additional information on what compliance activities it would engage in to ensure that FFIs are complying with the law. IRS employees were provided a generic compliance activity template to document their plans to identify noncompliant taxpayers, FFIs, and withholding agents. The documented activities related to FFI compliance, however, were lacking in detail, TIGTA explained. TIGTA cautioned that improper documentation of the IRS's plans to ensure FFI compliance with FATCA could hamper implementation of the law.

Withholding agents

TIGTA also reported that many of the compliance activities the IRS plans to complete with respect to taxpayers and FFIs will also be used to identify withholding agent noncompliance. Examples include comparing information on the various FATCA forms, identification of trends and collection/reporting patterns, and the use of sampling to select and review Forms 8938, Forms 8966, Forms 1042-S, etc., to identify potential FATCA noncompliance.

Form 8938

The IRS plans to monitor FATCA compliance by comparing data reported on Form 8938 for one year to data reported by the filer on a Form 8938 from a previous tax year. TIGTA identified several problems the IRS was encountering in the processing of paper Forms 8938. Data were being transcribed manually through the Integrated Submission and Remittance Processing System and were not validated to ensure accuracy. The remaining limitations involved the inability of Submission Processing function employees to transcribe Form 8938 continuation statements and negative dollar amounts.

Reference: TRC FILEBUS: 9,108.

Offshore

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the requirement that taxpayers owe $1,500 or less in taxes per year. The IRS also eliminated the reduced penalties for nonwillful taxpayers because of the streamlined procedures. Taxpayers who make a submission under the streamlined procedures are ineligible to participate in OVDP.

- ***Comment.*** Generally, taxpayers who enter the OVDP pay a penalty equal to 27.5 percent of the high value of the accounts. The penalty increases to 50 percent, the IRS explained, if, at the time the taxpayer initiated their disclosure, either a foreign financial institution at which the taxpayer had an account or a facilitator who helped the taxpayer establish or maintain an offshore arrangement had been publicly identified as being under investigation, the recipient of a John Doe summons or cooperating with a government investigation, including the execution of a deferred prosecution agreement or non-prosecution agreement (such as DOJ's Swiss Bank Program).

Disclosures

In 2014, the IRS announced that 45,000 taxpayers had made voluntary disclosures, paying $6.5 billion in back taxes, interest and penalties. Now, the OVDP monetary amount has increased to $8 billion from more than 54,000 taxpayers making disclosures. Some 30,000 taxpayers have used streamlined procedures, the IRS added.

Swiss Bank Program

DOJ's Swiss Bank Program provides a path for Swiss banks to resolve potential criminal liabilities in the United States. Generally, banks must make a complete disclosure of their cross-border activities; provide detailed information on an account-by-account basis for accounts in which U.S. taxpayers have a direct or indirect interest; and cooperate in treaty requests for account information, along with paying penalties.

Reference: TRC FILEBUS: 9,108.

REFERENCE KEY

FED references are to ***Standard Federal Tax Reporter***
USTC references are to ***U.S. Tax Cases***
Dec references are to ***Tax Court Reports***
TRC references are to ***Tax Research Consultant***

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IRS Reminds Employers, Insurers Of Approaching ACA Information Reporting Deadlines

HCTT-2015-64

The IRS has reminded employers and insurers of various deadlines under the *Affordable Care Act's* (ACA) new reporting requirements (Section 6055 reporting and Section 6056 reporting). The IRS had encouraged voluntary reporting starting in 2015 for the 2014 plan year. Mandatory reporting begins in 2016 for the 2015 plan year.

- ***Take Away.*** "The new forms and instructions closely follow versions that were published earlier this year, but make a few changes and clarifications," Edward Leeds, counsel, Ballard Spahr, LLP, Philadelphia, told CCH. "One clarification concerns what happens when an employer offers employees an insured health plan together with a health reimbursement account. Contrary to prior guidance, the employer will no longer need to report on coverage under the HRA. This exception extends to certain other situations where the availability of one type of minimum essential coverage is contingent on enrollment in another," Leeds explained.

Background

Under Code Sec. 6055, every provider of minimum essential coverage must report coverage information by filing an information return with the IRS and furnishing a statement to individuals. Code Sec. 6056 requires applicable large employers (ALEs) to file information returns with the IRS, and provide statements to their full-time employees about the health insurance coverage the employer offered.

For purposes of Code Sec. 6056, an ALE generally is required to report (among other information):

- The employer's name, address, and employer identification number;
- The calendar year for which information is being reported;
- A certification as to whether the employer offered to its full-time employees and their dependents the opportunity to enroll in minimum essential coverage under an employer-sponsored plan;
- The number of full-time employees eligible for coverage under the employer's plan; and
- The employee's share of the lowest cost monthly premium for self-only coverage providing minimum value offered to that full-time employee.
- ***Comment.*** Information reporting is used, among other purposes, to determine if an ALE is liable for a shared responsibility payment under Code Sec. 4980H. Information reporting is also used by the IRS to administer the individual shared responsibility requirement under Code Sec. 5000A.

New forms

The IRS has developed Forms 1094-B, Transmittal of Health Coverage Information Returns; 1094-C, Transmittal of Employer-Provided Health Insurance Offer and Coverage Information Returns; 1095-B, Health Coverage; and 1095-C, Employer-Provided Health Insurance Offer and Coverage, for reporting the requisite ACA information.

The IRS explained that employers with 50 or more full-time employees, including full-time equivalent employees, will use transmittal Form 1094-C and information return Form 1095-C to report about offers of health coverage and enrollment in health coverage for their employees. In addition to reporting the coverage that they offer, ALEs that sponsor self-insured group health plans will use Forms 1094-C and 1095-C to report information about the coverage they provide to the covered individuals. The IRS further explained that employers with fewer than 50 employees that are not subject to the ACA's employer shared responsibility provisions, but that sponsor self-insured group health plans, will use Forms 1094-B and 1095-B to report information about covered individuals.

Due dates

The IRS reminded filers that:

- Forms 1095-B and 1095-C are due to individuals by February 1, 2016.
- Forms 1094-B, 1095-B, 1094-C and 1095-C are required to be filed with the IRS by February 29, 2016 if filing on paper; or (February 28, 2016 falls on a Sunday and 2016 being a leap year, provides for an extra day in February: February 29 which is a Monday) or March 31, 2016, if filing electronically.

Reference: TRC HEALTH: 3,250.

Social Security Wage Base Stays At $118,500 For 2016; "Nanny Tax" Threshold Rises To $2,000

The Social Security Administration (SSA) has announced that the maximum amount of earnings subject to OASDI Social Security tax will remain at $118,500 for 2016, the same as for 2015. The SSA cost-of-living adjustments (COLAs) are based on the rise in the average Consumer Price Index for Urban Wage Earners and Clerical Workers (CPI-W) from the third quarter of 2014 through the third quarter of 2015.

- ***Comment.*** Likewise, monthly Social Security and SSI benefits will not automatically increase in 2016 for nearly 65 million Americans.

"Nanny" tax. For 2016, the domestic employee coverage threshold, as adjusted for a slightly different inflation factor and subject to rounding, will be $2,000, up from $1,900 in 2015. This amount had been unchanged since 2014. Earnings of any domestic employee are not subject to Social Security taxes if they do not exceed that threshold for the year.

SSA News Release and Fact Sheet, FED ¶¶46,427, 46,428; TRC INDIV: 63,052.

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IRS Proposes Updates To Administrative Appeals Process For Docketed Tax Court Cases

Notice 2015-72

The IRS has issued proposed updates the current procedures for referring cases docketed with the Tax Court to the IRS Office of Appeals for settlement. Proposed updates would, among other things, add more detail on which cases should not be referred to Appeals and remove the exclusion for certain cases involving employee plan qualification and the tax-exempt or foundation status of an organization. The procedures were last updated in 1987.

- ***Take Away.*** "The tax bar had been pressing the IRS to update the procedures for the administrative appeals process set forth in Revenue Procedure 87-24 in cases docketed in the United States Tax Court. Notice 2015-72 is welcomed guidance, as it lays out the procedure for post-docketed Appeals much more clearly, with more timelines and parameters added to govern the flow of a case between IRS counsel and IRS Appeals," Mary McNulty, partner, Thompson & Knight LLP, Dallas, told Wolters Kluwer.

Background

In 1987, the IRS issued Rev. Proc. 87-24, which outlined the procedures by which cases docketed in the Tax Court would be referred to the IRS Office of Appeals for settlement. Section 2 of Rev. Proc. 87-24 provided that District Counsel would refer a Tax Court case to Appeals unless Appeals had issued the statutory notice of deficiency. In that case, Counsel could refer the case to appeals unless it determined that there was "little likelihood that a settlement of all or a part of the case can be achieved in a reasonable period of time."

Rev. Proc. 87-24 also set a timeframe for referring and handling cases involving deficiencies of $10,000 or less, established Appeals' authority to negotiate settlement, and described how movement of the case between Appeals and Counsel should be handled. In addition, Rev. Proc. 87-24 excepted certain cases from its purview. Excluded cases include those in which the notice of deficiency, liability, or other determination was issued by Appeals, by the Employee Plans/Exempt Organizations function or by a District Director based on a National Office ruling or technical advice in that case involving qualification of an employee plan or tax exemption and/or foundation status of an organization (but only to the extent the case involves such issue).

Proposed procedures

The proposed revenue procedure adds specificity to the instances where cases should not be referred to Appeals. These include: cases in which Appeals issued the notice of deficiency or made the determination that is the basis of the Tax Court's jurisdiction or in which the taxpayer declined settlement consideration by Appeals.

- ***Comment.*** However, the proposed changes also provide Appeals with the option to issue a notice of deficiency or determination in order to meet the statute of limitations, but request Counsel to return the case to Appeals for full consideration of an issue or issues once the case is docketed in the Tax Court. If such request is made, the case will be treated for purposes of the referral as if Appeals did not issue the notice of deficiency or make the determination.

In addition, a case should not be referred to appeals if:

- It has been designated for litigation by Counsel;
- Division Counsel or a higher level Counsel official determines that referral is not in the interest of sound tax administration;
- The case is docketed under Code Secs. 6015(e)(1)(A)(i)(II), 6110, 6320 and 6330, 6402, 7428, 7476, 7477, 7478, and 7479;
- The case is docketed under Code Sec. 6213(a) and includes the issue of innocent spouse relief under Code Sec. 6015, raised for the first time in the petition.

Other notable changes include that Appeals may, with manager approval, decline to include Counsel in the settlement conference if it determines that Counsel's participation in the settlement conference will not further settlement of the case. The proposed procedures also establish a more detailed timeframe for when Appeals must return a small tax case to Counsel.

References: FED ¶46,426; TRC IRS: 24,106.

Federal Circuit Affirms Denial Of FICA Tax Refund Request On Deferred Comp; "Present Value" Regs Were Reasonable

Balestra, Jr., CA-FC, October 13, 2015

Married taxpayers were not entitled to a refund of taxes withheld under the *Federal Insurance Contributions Act* (FICA) from an amount of deferred compensation to be paid under a nonqualified plan, the Court of Appeals for the Federal Circuit has found, affirming the lower court. Although the employer's obligation to pay the taxpayers was discharged in bankruptcy—and the taxpayers never received the amount—the regulations stated that the amount in question was subject to a special timing rule whereby that would be taxed based on their present value. The court found that the IRS's interpretation of the regulations was entitled to deference.

- ***Take Away.*** The court's analysis centered around the second prong of the test outlined in *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984)*. Ultimately, the Circuit Court found that the IRS's interpretation of regulations under Code Sec. 3121 was reasonable.

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IRS Updates Guide For Safeguarding Taxpayer Data

Pub. 4557, Safeguarding Taxpayer Data – A Guide for Your Business

The IRS has posted an updated version of Publication 4557, Safeguarding Taxpayer Data - A Guide for Your Business, on its website. The update, which replaces the 2008 issue of the guide, is targeted to non-government businesses involved in the preparation and filing of returns.

- ***Take Away.*** Authorized e-file providers must adhere to security, privacy and business standards to protect tax information collected, processed and stored. Authorized e-file providers that own or operate a web site through which taxpayer information is collected, transmitted, processed, or stored, must register their uniform resource locator (URL).

Background

Safeguarding taxpayer data, the IRS explained, is a top priority for the agency. These safeguards are intended to preserve the confidentiality and privacy of taxpayer data by restricting access and disclosure and to protect the integrity of taxpayer data by preventing improper or unauthorized modification or destruction. Similarly, non-governmental businesses, organizations and individuals that handle taxpayer data to must understand and meet their responsibilities to safeguard taxpayer information, the IRS cautioned.

Security controls

To safeguard taxpayer information, organizations must determine the appropriate security controls for their environment based on the size, complexity, nature and scope of their activities, the IRS explained. Security controls are the management, operational and technical safeguards used to protect the confidentiality, integrity and availability of information.

Financial institutions as defined by Federal Tax Commission (FTC) include professional tax preparers, data processors, their affiliates and service providers who are significantly engaged in providing financial products or services. They must take certain steps to protect taxpayer information. Other businesses, organizations and individuals handling taxpayer information, the IRS recommended, should also follow these steps because they represent best practices for all.

- Take responsibility or assign an individual or individuals to be responsible for safeguards;
- Assess the risks to taxpayer information, including operations, physical environment, computer systems and employees, if applicable;
- Make a list of all the locations where taxpayer information is kept;
- Write a plan of how taxpayer information will be safeguarded;
- Put appropriate safeguards in place;
- Use only service providers that have policies in place to also maintain an adequate level of information protection; and
- Monitor, evaluate and adjust security programs as business or circumstances change.
- ***Comment.*** State governments provide best practice guidelines to safeguard consumer information, such as personal tax data. The National Institute of Standards and Technology (NIST), the IRS explained, also provides security guidelines and practices for federal agencies that nongovernmental organizations may use.

Reference: TRC IRS: 66,360.

Refund

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- ***Comment.*** Code Sec. 3121(v)(2)(A) provides that any amount deferred under a nonqualified deferred compensation plan shall be taken into account for [FICA tax] purposes . . . as of the later of—(i) when the services are performed, or (ii) when there is no substantial risk of forfeiture of the rights to such amount. For nonqualified deferred compensation plans that are also nonaccount balance plans, the regs define an "amount deferred" in terms of the "present value" of the deferred compensation (the future payments).

Background

The husband retired in 2004, at which point he began receiving payments under a nonqualified, nonaccount balance deferred compensation plan. Payments were scheduled to be made by his former employer throughout his life. His FICA tax obligation was calculated based on the present value of the deferred compensation payments.

At the time the taxpayer retired, his employer was in bankruptcy proceedings. Eventually the employer's obligation to make payments to the taxpayer under its nonqualified deferred compensation plan was discharged in bankruptcy. Ultimately, the husband received $63,032.09 in payments from his employer, less than 22 percent of the total amount of compensation on which he had been taxed under FICA.

The taxpayers sought a refund of FICA tax paid on the portion of compensation the taxpayer would not receive. The IRS denied the refund request. The Tax Court found in the IRS's favor.

Circuit court's analysis

The IRS made a reasonable choice to define the words "present value" by considering, inter alia, the time value of money and reasonable actuarial assumptions and methods at the time the amount deferred was taken into account as wages, the Federal Circuit found. This definition allowed for the consideration of some contingencies but not all. However, it was not unreasonable for the IRS not to consider in its valuation the contingency that the employer might became bankrupt.

Furthermore, the Federal Court rejected taxpayers' argument that the Treasury regulations did not articulate a satisfactory explanation for its action. The court found that the regs were not arbitrary and capricious, but instead provided "workable, simple, flexible rules for taxpayers."

References: 2015-2 USTC ¶50,517; TRC COMPEN: 15,208.

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IRS Determines Cancellation, Reissuance Of Limited Partnership Units Do Not Risk Losing Pass-Through Status

LTR 201541009

The cancellation and reissuance of limited partnership units would not be treated as a transfer for purposes of taxing the entity as a corporation under the publicly traded partnership (PTP) rules, the IRS has determined. The cancellation and reissuance were accomplished under an employee compensation agreement.

- ***Take Away.*** The IRS did not elaborate on its determination, merely indicating that the cancellation and reissuance of the units fell within the relevant statutory provisions and reulations.

Background

X and Y were both limited partnerships. Y was treated as a partnership for federal tax purposes. Y contributed its assets to X in a transaction under Code Sec. 721. As a result, the principal business activity of Y became owning units of limited partnership interest in X. At the time of the transaction, Y offered its unitholders a one-time opportunity to exchange their Y units for X units on a one-for-one basis.

- ***Comment.*** The units representing assignments of beneficial ownership of limited partnership interests in Y were publicly traded. In contrast, the units of X were not traded on a public exchange and were subject to substantial transfer restrictions.

Limited partnership X provided long-term incentive compensation awards to certain employees in the form of Y units. X would purchase Y units for the compensation plan throughout the year. Upon X's purchase of Y units, Y promptly would cancel the units. X would then cancel a corresponding number of X units held by Y. Each year, X would determine the amount of new awards under the compensation program and the number of Y units to be awarded to employees. X and Y would issue a corresponding number of new units to each other. Newly issued Y units would be awarded to the employees.

- ***Comment.*** X cancelled a corresponding number of X units to maintain the one-to-one correlation between outstanding X units and outstanding Y units.

IRS analysis

The IRS first observed that under Code Sec. 721, generally, no gain or loss is recognized to a partnership or to any of its partners in the case or a contribution of property to the partnership in exchange for an interest in the partnership. Under Code Sec. 731(a)(1), in the case of a distribution by a partnership to a partner, gain is not recognized to the partner, except to the extent that any money distributed exceeds the adjusted basis of the partner's interest in the partnership immediately before the distribution. Further, Code Sec. 731(b) provides that a partnership does not recognize gain or loss upon a distribution of property, including money, to a partner.

Additionally, Code Sec. 7704(a) provides that (except as provided in Code Sec. 7704(c)), a publicly traded partnership will be treated as a corporation. Code Sec. 7704(b) provides that the term "publicly traded partnership" means any partnership if interests in the partnership are traded on an established securities market and interests in the partnership are readily tradable on a secondary market (or the substantial equivalent thereof). Reg. 1.7704-1(a)(3) provides that for purposes of section 7704(b), a transfer of an interest in a partnership means a transfer in any form, including a redemption by the partnership or the entering into of a financial instrument or contract.

Here, the IRS determined that the cancellation and reissuance of units of limited partnership interest in X, as part of the compensation program, would not be treated as a transfer under Reg. § 1.7704-1(a)(3).

Reference: TRC PART 3,504.

Eleventh Circuit Affirms Disallowance Of FOCus Shelter Transactions; Penalties Waived

Kearney Partners Fund, LLC, CA-11, October 13, 2015

The Eleventh Circuit Court of Appeals has affirmed a district court's decision that a series of transactions lacked economic substance and should be disregarded for tax purposes. The transactions, which involved a three-tiered group of limited liability companies (LLCs), reflected the exact steps of the abusive "Family Options Customize" (FOCus) tax shelter. The Eleventh Circuit did not, however, apply the penalties imposed in the Final Partnership Administrative Adjustment (FPAA) because the individual who was the controlling member of the LLCs disclosed the existence of the tax shelter under an IRS penalty-waiver program.

- ***Take Away.*** The FOCus tax shelter was a tax-avoidance strategy marketed by a professional accounting firm in the early 2000s. It involves a series of preplanned transactions using a three-tiered partnership structure to generate artificial losses designed to offset capital gains. The IRS issued several Notices (including Notice 2000-44 and 2002-50) listing among its examples of abusive tax shelters a program that closely resembled the FOCus structure. A 2013 Fifth Circuit decision also affirmed a finding that this particular series of transactions lacked economic substance (*Nevada Partners Fund, LLC, CA-5,* 2013-2 USTC ¶50,398).

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TAX BRIEFS

Internal Revenue Service

The IRS has released a revenue procedure containing specifications for the private printing of red-ink substitutes for the 2015 revisions of Forms W-2 and W-3. Substitute forms are those forms that are not printed by the IRS. All such forms must comply with the specifications set out in the revenue procedure, which may not be varied by any IRS office. The guidance covers allowable logs and other graphics, printer specifications, requirements for substitute forms furnished to employees, and electronic delivery of Form W-2 and W-2c recipient statements.

Rev. Proc. 2015-51, FED ¶46,429; TRC FILEBUS: 12,052.10

Summons

Two IRS collection summonses issued to an individual to appear, testify and produce documents relating to an investigation into his federal tax liabilities were ordered enforced. The government established its prima facie case for enforcement under *Powell*. The individual failed to appear or disprove any of the government's *prima facie* case or show that enforcement would be an abuse of process.

Kaemmerer, DC Ill., 2015-2 USTC ¶50,516; TRC IRS: 21,300

An IRS administrative summons issued to an individual to appear, testify and produce documents relating to an investigation into his tax liability was ordered enforced. The individual failed to rebut the government's *prima facie* case for enforcement under *Powell*.

Grell, DC Minn., 2015-2 USTC ¶50,515; TRC IRS: 21,056

Income

The Tax Court properly held an individual liable for tax on unreported income for the tax years at issue, as well as tax on capital gain from the sale of real property, and properly imposed penalties for instituting proceedings in the Tax Court primarily for purposes of delay. The taxpayer's argument that the Fifth Amendment to the U.S. Constitution somehow alleviated his liability was rejected. He had no well-founded fear of prosecution and offered only conclusory arguments.

Rader, CA-10, 2015-2 USTC ¶50,519; TRC FILEIND: 18,102

Carryforwards

The government was required to recalculate an individual's taxes to apply his capital loss carry forward for the tax years at issue, using the individual's cost basis data for sales and securities and classifying them as long-term and short-term capital gains and losses. The government failed to rebut the individual's determination of cost basis of the securities sold and show that the individual's resulting carryforward losses were incorrect.

Hughes, DC Mass., 2015-2 USTC ¶50,514; TRC SALES: 6,052

Deductions

Individuals who were the shareholders of a corporation were not entitled to claim the corporation's advertising expenses and depreciation expenses in excess of amounts allowed by the IRS for the year at issue, and were liable for substantial understatement penalties. The taxpayer did not properly substantiate any of its advertising expenses and thus was not entitled to any deduction. The taxpayer failed to introduce records, mileage logs, receipts, or other credible evidence that would prove entitlement to the depreciation expense deduction for any of the three vehicles. Finally, taxpayers acted negligently because they failed to keep adequate books and records, did not exercise reasonable care, received unreported income and claimed deductions for personal expenses on their returns.

WSK and Sons, Inc., TC, Dec. 60,430(M), FED ¶48,140(M);TRC BUSEXP: 3,100

Married individuals were not entitled to deduct expenses and losses related to a business characterized as a "second hand metal dealer", because they failed to establish that they were ordinary and necessary expenses incurred to carry on the business. Although the taxpayers were involved in a scrap metal business owned and operated by the husband's brother, they produced no evidence to substantiate that they operated

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Draft Instructions For Form 1041, Schedule D, Reflect New Estate Tax Basis Reporting Requirement

Recently-released draft instructions for Schedule D (Capital Gains and Losses), Form 1041 (U.S. Income Tax Return for Estates and Trusts) confirm the requirement that an estate (or other person) required to file an estate tax return after July 31, 2015, must provide a statement that includes the estate tax value of property reported on the return to both the IRS and any beneficiary who receives property from the estate. Consistent with the *Surface Transportation and Veterans Health Care Choice Improvement Act of 2015,* the draft instructions provide that:

An estate (or other person) required to file an estate tax return after July 31, 2015, must provide a statement that includes the estate tax value of property reported on the return to both the IRS and any beneficiary who receives property from the estate; and

If the property increases the estate tax liability, the beneficiary must use a basis consistent with the estate.

- ***Comment.*** Notice 2015-57, issued in August 2015, delayed the due date for the estate reporting requirements until February 29, 2016, so that "more specific guidance could be developed." The latest draft instructions confirm that any such guidance will not move the original July 31, 2015 start date keyed to the estate tax return. The new reporting rules are designed to ensure consistent basis reporting between an estate and a person acquiring property from a decedent.

Draft Instructions for Schedule D (Form 1041), October 15, 2015; TRC SALES: 6,156.

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Tax Briefs

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the independent scrap metal business for which they claimed the business deduction. The taxpayers were not liable for accuracy-related penalties because they showed that they reasonably relied on their tax advisor.

Espaillat, TC, Dec. 60,428(M), FED ¶48,138(M); TRC BUSEXP: 3,050

Married individuals were not entitled a charitable deduction in excess of the amount determined by the IRS. Further, the taxpayers were liable for the accuracy-related penalty under Code Sec. 6662(a) for unreported income that the IRS determined in its notice. Further, the taxpayers were liable for the negligence penalty under Code Sec. 6662(a). The taxpayers failed to show they were not negligent in failing to include the amount of unreported income in their return for the tax year at issue.

Wesley, TC, Dec. 60,426(M), FED ¶48,136(M); TRC INDIV: 51,450

Tax Credits

An individual was not entitled to claim dependency exemption for his four children since he failed to satisfy the principal place of abode requirement under Code Sec. 152(c)(1)(B), and was therefore not entitled to the child tax credit, the additional child tax credit, or the earned income credit. However, the taxpayer was not liable for accuracy-related penalty under Code Sec. 6662(a).

Gassoway, TC, CCH Dec. 60,429(M), FED ¶48,139(M);TRC FILEIND: 6,154

Innocent Spouse

The government was entitled to reduce to judgment federal income tax liabilities assessed against a married couple. The wife disputed her tax liability but failed to rebut the presumption of correctness that attached to the tax assessments.

Stein, DC Ky., 2015-2 USTC ¶50,521; TRC INDIV: 18,052.20

Refund Claims

The Court of Federal Claims lacked subject matter jurisdiction over a corporation's refund claims alleging erroneous collection of large corporate underpayment (LCU) interest by the IRS. The claims were filed outside the six-month limitations period provided in Code Sec. 6230(c)(2)(A) for challenges to IRS computational adjustments.

General Mills, Inc., FedCl, 2015-2 USTC ¶50,520; TRC LITIG: 9,052

Deficiencies and Penalties

Married individuals failed to timely file a valid joint tax return for the year at issue because the return they filed omitted the wife's signature. The taxpayers were liable for the addition to tax for their delay in timely filing a return. The taxpayers failed to exercise ordinary business care and prudence by inquiring why their original return was sent back although they had been filing tax returns for many years and had never previously received back their returns.

Reifler, TC, CCH Dec. 60,425(M), FED ¶48,135(M); TRC FILEIND: 18,056.35

Transferee Liability

A corporation's sole shareholder was liable as transferee with respect to the corporation's unpaid federal tax liability. There was no actual sale of the corporation's stock; rather, the corporation was liquidated, and the cash received from the sale of corporation's assets was distributed to the shareholder, less a fee the purported buyer retained for its role in facilitating the transaction. Under state (Ohio) law, the shareholder was liable as transferee for the corporation's unpaid tax liability because the transaction was in substance a liquidation and dissolution, and the shareholder received a cash distribution from the corporation.

Tricarichi, TC, Dec. 60,427(M), FED ¶48,137(M);TRC IRS: 60,052

Shelter

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Background

In late 2001, an individual used the LLCs, a three-tiered group of limited liability companies treated as partnerships for tax purposes, to generate artificial, noneconomic tax losses to offset $80 million in capital gains obtained from the sale of his business. The IRS issued FPAAs disallowing all the tax benefits generated by the transactions.

In early 2002, the IRS issued Announcement 2002-2, which introduced an amnesty program under which a taxpayer who properly disclosed his involvement in a tax shelter could obtain a waiver of certain accuracy-related penalties. After learning of the program, the individual disclosed the tax shelter on his and the LLC's behalf as the controlling member.

Court's analysis

The Eleventh Circuit found that the district court had correctly affirmed the IRS's disallowance of the tax benefits of the transactions. It correctly held that every step of the transactions, including straddle trades, creation, setup, sales, purchases of partnerships, foreign currency trades, capital contributions and a guarantee, was motivated solely by tax avoidance and failed both prongs of the economic substance test. There was no reasonable possibility of making a profit at any point.

There was no legitimate business purpose for the transactions. Rather, the accounting firm specifically created the transactions to generate a tax loss for the individual, who entered into the transactions solely for the tax benefits. The fact that the transactions at issue matched a presentation shown to the individual by the accounting firm at the outset was compelling evidence that the scheme was conceived purely as a tax shelter and that it performed as planned.

The LLCs were not, however, liable for the accuracy related penalties imposed by the IRS in the FPAA. The individual relied on Announcement 2002-2 in disclosing his investment in the LLCs, and this disclosure brought about the IRS's discovery of the FOCus shelter. The disclosure was in compliance with Announcement 2002-2, and the IRS should be held to its terms, the Eleventh Circuit found. The court noted that it was disingenuous for the IRS to apply penalties for a shelter under an Announcement that prompted the uncovering of the shelter in the first place.

References: 2015-2 USTC ¶50,518; TRC PART: 60,552.

PRACTITIONERS' CORNER

Year-End Strategies: Leveraging Traditional Techniques And New Developments

Year-end tax planning for individuals and businesses provides not only the opportunity to review the activities of the past year, it also generates an invaluable opportunity to leverage tax planning techniques as they relate to new developments. As in past years, individuals and businesses need to question the status quo, explore new strategies, and evaluate potential plans – most of which is done best before the current tax year closes.

- ***Comment.*** Tax legislation – or the lack of tax legislation –is again an essential consideration in year-end planning. A host of individual and business tax extenders had not yet been renewed by Congress for 2015. Comprehensive tax reform continues to be discussed in Washington, but as year-end approaches it is almost certain that no major changes will be made to the Tax Code. Some stand-alone bills and possible revenue provisions within a Highway Bill, as well as the expected passage of the tax extenders, may provide year-end planning opportunities.

The following Practitioners' Corner observations are adapted from the latest Wolters Kluwer Tax Briefing, "2015 Year-End Tax Planning." The full Tax Briefing appears on IntelliConnect.

Year-End Individual Planning

Assessing current income or expenses, gains and losses, to map out a year-end buy, sell or hold strategy later makes particular sense, as markets –and the economy in general-- continue to make adjustments.

Income and capital gains/ dividends. Spikes in income, whether capital gains or other income, may push capital gains into either the top 39.6 percent bracket (for short-term gains) or the 20 percent capital gains bracket. Spreading the recognition of certain income between 2015 and 2016 may help minimize the total tax paid for the 2015 and 2016 tax years. And those individuals finding themselves in the 15 or 10 percent tax brackets should consider recognizing any long-term capital gain available to the extent that, with other anticipated income, will not exceed the top of the 15 percent bracket ($74,900 for joint filers and $37,450 for singles in 2015).

"Individuals and businesses need to question the status quo, explore new strategies, and evaluate potential plans...."

Net Investment Income Tax. Since creation of the NII tax, individuals have learned that NII encompasses more than capital gains and dividends. NII includes income from a business in which the taxpayer is a passive participant. Rental income may also be considered NII unless earned by a real estate professional. The NII threshold amount is equal to: $250,000 in the case of joint returns or a surviving spouse; $125,000 in the case of a married taxpayer filing a separate return, and $200,000 in any other case. These threshold amounts are not indexed for inflation.

Tax extenders for individuals. Under current law, a number of popular but temporary tax incentives are not available for 2015 unless extended by Congress. For individuals, these include the state and local sales tax deduction, the higher education tuition and fees deduction, a mortgage debt forgiveness exclusion, the teachers' classroom expense deduction and the Code Sec. 25C residential energy property credit.

Estate and gift taxes. The maximum federal unified estate and gift tax rate is 40 percent with an inflation-adjusted $5 million exclusion (up to $5.43 million for gifts made and estates of decedents dying during 2015). The annual, use-it-or-lose-it gift tax exclusion allows taxpayers to give up to an inflation-adjusted $14,000 to any individual ($28,000 for married individuals who "split"gifts), gift-tax free and without counting the amount of the gift toward the lifetime $5 million exclusion, adjusted for inflation and double for married couples who share the exclusion.

Affordable Care Act. Unless exempt, the Affordable Care Act (ACA) requires that all individuals carry minimum essential coverage or make a shared responsibility payment. Individuals with health insurance coverage should ascertain that their coverage satisfies the ACA's minimum essential coverage requirements. Individuals without minimum essential coverage may be liable for a shared responsibility payment unless exempt. Individuals who obtain health insurance coverage through the ACA Marketplace may be eligible for the Code Sec. 36B premium assistance tax credit.

Year-End Business Planning

As in past years, business tax planning is uncertain because of the expiration of many popular but temporary tax breaks that have been part of an "extenders"package of legislation. Also added to the mix is the far-reaching ACA. Other changes to the tax laws in 2015 made by new regulations and other IRS guidance should also be considered in assessing year-end strategies.

Code Sec. 179 expensing. Code Sec 179 property includes new or used tangible property that is depreciable under Code Sec. 1245 and that is purchased to use in an

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WASHINGTON REPORT *by the Wolters Kluwer Washington News Bureau*

Congress returns from recess, highway funding and extenders on agenda

Lawmakers have returned to Washington after their Columbus Day recess. The House GOP continues to search for a replacement for Speaker John Boehner, R-Ohio, who is set to step down once his successor has been elected. House and Senate members also are expected to move a multi-year highway and transportation funding bill, likely with some tax offsets. The House Transportation and Infrastructure Committee has scheduled a markup of its multi-year highway bill for October 22. Lawmakers are not expected to increase the federal gas tax, which is currently 18.4 cents per gallon. Lawmakers also are unlikely to tackle any international tax reforms to pay for a highway bill. "We all share the same goal of completing a long-term bill as soon as possible, and ensuring that critical programs do not shut down before we achieve that goal is the right thing to do," Rep. Bill Shuster, R-Pa., chair of the House Transportation and Infrastructure Committee," told reporters. The Senate may also take up a package of tax extenders approved by the Senate Finance Committee this past summer.

Coalition urges reforms to tax treatment of carried interest

A coalition of 52 organizations is urging lawmakers to reform the taxation of carried interest. "Closing the carried interest loophole should be among the first items considered in the ongoing negotiations to prevent the damaging and indiscriminate sequester cuts and to invest in critical programs that support low-and middle-income Americans," the organizations wrote to Congress on October 14. The coalition stated that the fees are compensation for services, this income should be taxed as ordinary income just like the compensation others earn from work. Pending legislation, the Carried Interest Fairness Bill (Sen 1686), was recently estimated by the Joint Committee on Taxation to raise $15.6 billion in revenue over 10 years.

Tax executives weigh in on prospects for reform

A majority of tax executives believe that tax reform will occur within the next several years, with 67 percent seeing the likelihood that tax reform will happen in 2018 or earlier, according to the Tax Council/Ernst & Young LLP Tax Reform Business Barometer. Respondents gave a 41 percent likelihood that tax reform will happen in 2017 or earlier, and they believe 2017 is the most likely year for tax reform, with a 31 percent likelihood.

Business tax professionals view businesses-only or international-only tax reform as more likely than a comprehensive reform affecting both individual and corporate taxation, according to the survey. Sixteen percent of respondents think tax reform will affect only corporations, all businesses including pass-throughs (22 percent) or international (22 percent), while 40 percent believe reform will be comprehensive. In the January 2015 Barometer, which did not include the option for an international only reform, 12 percent and 47 percent of respondents thought tax reform would affect only corporations or all businesses including pass-throughs, respectively, while 40 percent thought reform would be comprehensive.

The survey found that a majority of respondents (61 percent) expect tax reform will be revenue-neutral, rather than raise revenue, 30 percent believe it will raise revenue and 9 percent think it will reduce revenue. Respondents gave a median expectation of 25 percent that the House Ways and Means Committee will release a specific tax reform plan by the end of 2015, down from a 50-percent median likelihood in the January 2015 Barometer. Respondents believe it is almost equally likely (20-percent median likelihood) that the Senate Finance Committee will release a specific tax reform plan by the end of 2015, also down from the 50 percent reported in the January 2015 Barometer. Eighty-four U.S. tax executives and practitioners responded to the survey, which was conducted between June 16 and June 25, 2015.

TIGTA reviews IRS employee workstation upgrades

The IRS was unable to upgrade all of its Windows workstations from Windows XP and all of its Windows servers from Windows Server 2003 by the Microsoft end of life deadlines, according to the Treasury Inspector General for Tax Administration (TIGTA). TIGTA discovered that the IRS did not follow established policies over project management and provided inadequate oversight and monitoring of the Windows XP upgrade early in its effort.

Operating systems are critical software on computers that serve as a foundation to allow all other programs, software, and applications to run on the computers. For the IRS, the use of outdated operating systems may expose taxpayer information to unauthorized disclosure, which can lead to identity theft. Further, network disruptions and security breaches may prevent the IRS from performing vital taxpayer services, such as processing tax returns, issuing refunds and answering taxpayer inquiries.

TIGTA recommended that the IRS: (1) ensure that all workstations have been adequately accounted for and upgraded to Windows 7; (2) ensure that enterprise-wide information technology maintenance and upgrade efforts going forward follow the Enterprise Life Cycle, as prescribed by IRS policy, to mitigate potential delays and to ensure project transparency and accountability; and (3) require appropriate executive committees to oversee enterprise-wide information technology maintenance and upgrade efforts with regular project reviews and executive approvals.

The IRS partially agreed with the second recommendation. It disagreed that all upgrade efforts should follow the Enterprise Life Cycle but agreed that large-scale, enterprise-wide efforts need to have a set of well-documented minimum project documentation requirements to ensure that effective project management is adhered to for projects of this size.

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active trade or business. Under enhanced expensing, for 2014 and prior years, businesses could write off ("expense") up to $500,000 in qualifying expenditures, and would not reduce this amount unless expenditures exceed $2 million. Until the enhanced provisions are extended, these limits, respectively, are $25,000 and $200,000 for 2015 and later years.

Bonus depreciation. Congress provided for 50-percent bonus depreciation through 2014 (through 2015 for certain transportation and other property). Legislation introduced in Congress in 2015 would extend bonus depreciation through 2016 or, alternatively, make bonus depreciation permanent.

Other business extenders. Many other beneficial tax provisions for business are up for consideration in extenders legislation for 2015 and beyond. These include the research tax credit; small business stock; S corp built-in gains; New Markets Tax Credit; Work Opportunity Tax Credit; employer wage credit for activated military reservists; Subpart F provisions; enhanced deduction for contributions of food inventory; empowerment zones; Indian employment credit; low-income credits for subsidized new buildings and military housing; treatment of regulated investment companies (RICs); and basis reduction of S corporation stock after donations of property.

"Repair" regulations. A potentially beneficial provision in final, so-called "repair"regulations is the *de minimis* safe harbor. The safe harbor enables taxpayers to routinely deduct items whose cost is below the specified threshold. The *de minimis* safe harbor is an annual election, not an accounting method, so it can be made and changed from year to year. The current threshold is set at: $5,000 for taxpayers with an applicable financial statement (taxpayers with an AFS should have a written policy in place by the beginning of the year that specifies the amount deductible under the safe harbor); and $500 for taxpayers without an AFS.

Standard mileage rate. The standard business mileage allowance rate for 2015 is 57.5 cents-per-mile (up from 56 cents-per-mile for 2014).

Vehicle depreciation limits. The IRS released the inflation-adjusted limitations on depreciation deductions for business-use passenger automobiles, light trucks, and vans first placed in service during calendar year 2015. The IRS also modified the 2014 first-year limitations by $8,000 to reflect passage of the *Tax Increase Prevention Act of 2014,* which retroactively extended bonus depreciation for 2014 late last year. It is uncertain whether anticipated 2015 extenders legislation will make the same retroactive adjustment for 2015.

Affordable Care Act -- PACE Act. In October 2015, Congress passed the *Protecting Affordable Coverage for Employees (PACE) Act*, which maintains the current language in the ACA that defines "small employer" as an employer with fewer than 50 full-time employees on average during the prior calendar year for purposes of the small group health market. The PACE Act, however, gives states the option to apply the original definition of small employer to employers with 51 to 100 employees for purposes of the small group health market. Employers should check state law.

Small Business Health Care Tax Credit. Small employers with no more than 25 full-time equivalent employees may qualify for a special tax credit to help offset the cost of health insurance for their employees. The employer must pay average annual wages of no more than $50,000 per employee (indexed for inflation) and maintain a qualifying health care insurance arrangement.

Filing/Reporting Changes

Due to changes in the tax laws and other events, some deadlines will be changing starting in 2016; with others starting for 2016 returns filed in 2017. As a result, planning at year-end 2015 might start factoring in some of these deadlines when setting out schedules and strategies at the start of 2016. Notably, under the *Surface Transportation and Veterans Health Care Choice Improvement Act of 2015,* partnerships will be subject to an earlier March 15 deadline and C corporations generally will move to an April 15th deadline starting for 2016 tax year returns. Extensions-to-file are also adjusted. The FBAR deadline also will move, from June 30 to April 15.

Individual returns. A Washington, D.C. holiday, Emancipation Day, will shift the filing and payment deadline for 2015 individual returns from April 15, 2016 to April 18, 2016. Taxpayers in two states (Maine and Massachusetts) will have one additional day to file because of Patriots Day, which will be observed on April 18, 2016 in those states.

Estate tax uniform basis reporting. The IRS delayed new uniform basis reporting requirements for estate tax property until February 29, 2016. The delay was provided to give the IRS time to issue guidance to executors, beneficiaries, and others on how to comply with the new reporting requirements.

Traditional Year-End Planning Techniques

While new and pending developments play a critical role in year-end tax planning, traditional year-end planning techniques should not be overlooked. These techniques principally hinge upon the goal of smoothing out taxable income between the year about to close and the next year as best as can be predicted. In turn, such planning relies on strategies to accelerate or deferred income and expenses as required. Some of the most common techniques include:

Income Acceleration into 2015 (for deferral to 2016, delay the following actions):

- Sell outstanding installment contracts;
- Receive bonuses before January;
- Sell appreciated assets;
- Redeem U.S. Savings Bonds;
- Declare special dividend;
- Complete Roth conversions;
- Accelerate debt forgiveness income;
- Maximize retirement distributions;
- Accelerate billing and collections;
- Avoid mandatory like-kind exchange treatment; and
- Take corporate liquidation distributions in 2015.

Deductions/Credit Acceleration into 2015 (for deferral to 2016, take contrary actions as appropriate):

- Bunch itemized deductions into 2015/ Standard deduction into 2016;
- Don't delay bill payments until 2016;
- Elect expensing/accelerated depreciation;
- Pay last state estimated tax installment in 2015;
- Don't delay economic performance;
- Watch AGI limitations on deductions/ credits;
- Watch net investment interest restrictions; and
- Match passive activity income and losses.

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COMPLIANCE CALENDAR

October 23
Employers deposit Social Security, Medicare, and withheld income tax for October 17, 18, 19, and 20.

October 28
Employers deposit Social Security, Medicare, and withheld income tax for October 21, 22, and 23.

October 30
Employers deposit Social Security, Medicare, and withheld income tax for October 24, 25, 26, and 27.

November 4
Employers deposit Social Security, Medicare, and withheld income tax for October 28, 29, and 30.

November 6
Employers deposit Social Security, Medicare, and withheld income tax for October 31, November 1, 2, and 3.

November 10
Employees who received $20 or more in tips during October must report them to their employer. Form 4070 may be used.

November 12
Employers deposit Social Security, Medicare, and withheld income tax for November 4, 5, and 6.

TRC TEXT REFERENCE TABLE

The cross references at the end of the articles in Wolters Kluwer Federal Tax Weekly (FTW) are text references to Tax Research Consultant (TRC). The following is a table of TRC text references to developments reported in FTW since the last release of New Developments.

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FROM THE HELPLINE

The following questions have been answered recently by our "Wolters Kluwer Tax Research Consultant" Helpline (1-800-344-3734).

Q An individual orders a hybrid automobile and pays a deposit when the credit for purchasing the automobile is $3,300. The car is delivered four months later, when the credit is $2,475. What is the credit that can be claimed?

A The answer depends on when the vehicle is placed in service. If the customer has made a binding purchase upon paying the deposit, it appears that the vehicle may be placed in service when ordered, and a $3,300 credit can be claimed. If the customer's deposit is refundable, it appears that the customer has not made a binding purchase at the initial date and that the deposit merely gives the customer an option to buy the vehicle. In this case, the vehicle is not placed in service until it is delivered, and a $2,475 credit can be claimed if the customer purchases the vehicle. *See TRC INDIV: 57,708.*.

Q Is a one-day return for the target S corp in a type A merger situation required to be filed when the merger took place on January 2?

A There does not appear to be an exception to the general requirement of the filing of a return for a short tax year that would apply. Code Sec. 381(b)(1) states that, except in the case of an F reorganization, the tax year of the distributor or transferor corporation (that is, the corporation distributing or transferring assets to the acquiring corporation) shall end on the date of the distribution or transfer. Reg. §1.381(b)-1(c) states, in part, that the distributor or transferor corporation shall file an income tax return for the taxable year ending with the date of distribution or transfer. Further, Reg. §1.443-1(a)(2) states that if a taxpayer is not in existence for the entire tax year, a return is required for the short period during which the taxpayer was in existence. *See TRC ACCTNG: 24,256, ACCTNG: 24,258 and FILEBUS: 15,058.*